INDONESIA UPDATE

INDONESIA: INDONESIAN CENTRAL BANK PUBLISHES BUSINESS ACTIVITIES AND OFFICE NETWORK REGULATION

Bank Indonesia ("BI"), the Indonesian central bank, has now published its long awaited Business Activities and Office Network Regulation ("BAON Regulation"). This Regulation is often dubbed the "Multiple Licence" regulation in the press. The BAON Regulation – together with the recent 2012 BI Regulation on Ownership of Shares in General Banks ("Bank Ownership Regulation") and the 2012 BI Regulation on Single Presence Policy ("New SPP Regulation") – constitutes a significant overhaul of the regulatory landscape for banks in Indonesia and has helped reduce to an extent, but not completely, the regulatory uncertainty which has recently inhibited bank M&A transactions. It is expected that, as these Regulations become better understood, they will provide greater clarity to facilitate further M&A transactions in the banking sector in Indonesia, although the spectre of a possible new Banking Law, currently being considered by the Indonesian Parliament, may still undermine this. It is too early to determine how the draft Banking Law will end up but recent press reports suggest that the current draft contains a requirement that no investor can have a controlling share in more than one bank, which may contradict the New SPP Regulation which allows an investor to control two or more banks as long as it forms a holding company to oversee the two banks. It will be interesting to see how BI responds to this separate and partially inconsistent initiative from the Indonesian parliamentary process.

1. Core Capital
   • A key concept under the BAON Regulation is the size of the Core Capital of a bank, as this will in turn determine among other things:
     (a) The scope of the bank’s permitted business activities and the products it may offer.
     (b) The amount of credit or finance the bank must channel to "productive sectors" (including credit or finance to micro, small and medium sized enterprises).
     (c) The extent to which the bank may carry out branch or network expansion.

2. BUKU Classification
   • BI now classifies banks into four categories, by reference to the size of their Core Capital (the terminology adopted is "BUKU 1 to 4", where "BUKU" is the Indonesian acronym for "General Bank based on Business Activities").
(a) BUKU 1 are banks with Core Capital of less than IDR1,000,000,000,000,000 (one trillion Rupiah) (currently, approximately, US$103 million).

(b) BUKU 2 are banks with Core Capital of between IDR1,000,000,000,000,000 (one trillion Rupiah) (currently, approximately, US$103 million) and IDR5,000,000,000,000,000 (five trillion Rupiah) (currently, approximately, US$516 million).

(c) BUKU 3 are banks with a Core Capital of between IDR5,000,000,000,000,000 (five trillion Rupiah) (currently, approximately, US$516 million) and IDR30,000,000,000,000,000 (thirty trillion Rupiah) (currently, approximately, US$3.1 billion).

(d) BUKU 4 are banks with a Core Capital of at least IDR30,000,000,000,000,000 (thirty trillion Rupiah) (currently, approximately, US$3.1 billion).

3. Permitted Activities

• The permitted business activities of a Conventional General Bank will be determined by reference to the BUKU classification of the relevant bank. The BAON Regulation sets out the permitted activities for banks falling under each BUKU classification. A bank which is currently conducting a business activity which is not compatible with its BUKU classification as set out above must either adjust its business activity so as to become compatible with its BUKU classification, or increase its Core Capital, by no later than end of June 2016.

4. Productive Sectors

• Importantly, banks are now obliged to distribute credit or provide finance to "productive sectors" (which, for this purpose, include credit or finance for the purpose of investment and/or working capital rather than consumption, whether to Micro, Small and Medium Sized Enterprises (or, using its Indonesian acronym, "UMKM") debtors or customers, or non-UMKM debtors or customers). The minimum extent to which a bank is required to finance "productive sectors" is determined by reference to its BUKU classification (subject to certain exemptions for banks which focus on financing of home ownership). Specifically:

  (a) in the case of a BUKU 1 bank) a minimum of 55% of the bank's total credit or financing;
  (b) in the case of a BUKU 2 bank) a minimum of 60% of the bank's total credit or financing;
  (c) in the case of a BUKU 3 bank) a minimum of 65% of the bank's total credit or financing; and
  (d) in the case of a BUKU 4 bank) a minimum of 70% of the bank's total credit or financing,

must be used to finance "productive sectors".

• The obligation on banks to distribute credit or provide finance to "productive sectors" must also be complied with by no later than end of June 2016.

5. Office Network Expansion

• A bank is required to obtain prior approval from BI before undertaking an Office Network Expansion in the form of (a) branch office or (b) representative and other offices outside Indonesia. Other types of Office Network Expansion must be reported to, and obtain the confirmation of, BI. For this purpose, "Office Network Expansion" is defined to include office opening, including any address relocation of an office or change of status of the bank office.

• In order to be eligible to undertake an Office Network Expansion, a bank must meet the following requirements:

  (a) achieve a composite bank health rating of 1, 2, or 3 for the previous 1 year ("Bank Health Rating Requirement"); and
  (b) make available allocated Core Capital in accordance with the location and type of office being set up ("Capital Allocation Requirement"). How the Capital Allocation Requirement will be calculated remains subject to further detailed guidance to be provided in BI circulars (which is yet to be published). In broad terms, a higher amount of "allocated Core Capital" will be required for banks to expand in zones within Indonesia which are considered by BI to be saturated.
• Unlike the new permitted business activities rules which are applied retrospectively (in the sense that the affected banks must either limit the scope of their current business activities, or increase their Core Capital, by end of June 2016), the new rules on branch or network expansion are prospective in nature (in the sense that they are applicable with respect to banks’ branch or network expansion going forward).

6. Underlying Policies

• The stated key underlying policies underpinning the BAON Regulation are as follows:

(a) Encouraging large Indonesian banks to qualify for the anticipated "Qualified ASEAN Bank" category, whereby these banks may operate freely within the ASEAN region by 2020, pursuant to the regional initiative to further integrate the financial sector in the ASEAN region.

(b) Strengthening the capital of banks in anticipation of risks that may arise from the complexity of the business activities undertaken by banks, and to ensure that network expansion is not carried out using funds collected from the public.

(c) Prioritizing efforts to increase efficiency of banks in order to increase resilience and competitiveness in carrying out their business activities and in their network expansion.

(d) Increasing the role played by banks as financial intermediaries, particularly for "productive activities", including for the development of micro, small and medium sized enterprises.

Please click here for our previous e-bulletin on the Bank Ownership Regulation.

Please click here for our previous e-bulletin on the New SPP Regulation.

7. Contacts

David Dawborn (Partner)
Jakarta
T +62 21 5790 0571
david.dawborn@hsf.com

Haydn Dare (Partner)
Jakarta
T +62 21 5790 2830
haydn.dare@hsf.com

Vik Tang (Counsel)
Jakarta
T +62 21 5790 2829
vik.tang@hsf.com

Iril Hiswara (Partner)
Hiswara Bunjamin & Tandjung
T +62 21 574 4010
iril.hiswara@hbtlaw.com

Adrian Cornellius Pranata (Senior associate)
Hiswara Bunjamin & Tandjung
T +62 21 574 4010
cornellius.adrian@hbtlaw.com